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In the Supreme Court of the United States

OCTOBER TERM, 1993

MARC ALAN LEVIN, EXECUTOR, ESTATE OF MYRTLE S. LEVIN PRINCE, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, in computing estate tax liability under Section 2001 of the Internal Revenue Code, petitioner should have taken into account taxable gifts made in 1984 but erroneously treated as exempt from gift tax in that year.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 986 F.2d 91. The opinion of the United States Tax Court (Pet. App. 8a-15a) is unofficially reported at 61 T.C.M. (CCH) 2594.

JURISDICTION

The judgment of the court of appeals was entered on February 19, 1993. The petition for a writ of certiorari was filed on May 19, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Decedent Prince, a resident of Georgia, filed federal gift tax returns for each year from 1979 through 1985. Pet. App. 9a. On her 1984 gift tax return, decedent reported various taxable gifts (primarily stocks and bonds), and in addition noted the following:

> On May 30, 1984, the donor made gifts (exempt from gift tax under the Housing Act of 1937) of Atlanta, Georgia Project Notes, 5.82%, issue date 4-01-84, due 3-05-85.

Ibid. The Atlanta Project Notes, which had an undisputed fair market value of $20,000 on the date of the gifts, were not included in the gifts subject to tax on the return. At the time of filing the return, there was authority that a transfer of such notes was not subject to gift or estate tax. *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd as modified, 757 F.2d 920 (7th Cir. 1985). That authority was overruled, however, in *United States* v. *Wells Fargo Bank*, 485 U.S. 351 (1988). See Pet. App. 9a n.2.

After taking into account the annual gift tax exclusion provided by Section 2503(b) of the Internal Revenue Code (26 U.S.C. 2503(b)) and partial use of the credit provided by Section 2505 of the Code, decedent reported no gift tax due. Pet. App. 3a. Even if the notes had been included as taxable gifts on decedent's 1984 gift tax return, there would have been no gift tax due; the only adjustment would have been use of an additional portion of the unified credit. *Ibid.* The three-year period of limitations for assessment of gift tax with respect to 1984 expired on April 15, 1988. Because any gift tax liability with respect to the notes would have been offset by decedent's remaining unified credit, the Internal Revenue Service could not in any event have collected any amount of gift tax for 1984.

Decedent died on March 4, 1985. Pet. App. 3a. Her estate filed a timely federal estate tax return, *id.* at 9a, but did not include the gifts of notes made in 1984 in computing the estate tax due under Section 2001(b) of the Code. In a notice of deficiency dated June 2, 1989, the IRS asserted a deficiency in decedent's estate tax on the ground that the value of the notes should have been included in the "adjusted taxable gifts" taken into account under Section 2001(b)(1)(B). Petitioner sought redetermination of the asserted deficiency in the Tax Court, asserting that the gift tax statute of limitations barred revision of the amount of taxable gifts reported in 1984, and hence barred the asserted increase in "adjusted taxable gifts" for estate tax purposes. Pet. App. 3a, 8a-11a.

The Tax Court held that the Commissioner properly included the value of the notes in the decedent's "adjusted taxable gifts" for purposes of Section 2001(b). The court rejected the estate's position that Section 2504(c) of the Code required that the notes be assigned no value for estate tax purposes because the decedent reported the gifts of the notes on her 1984 gift tax return, attributing no taxable value to the gifts at that time, and the statute of limitations for assessment of additional gift tax for that year had expired. Section 2504(c) bars revaluation of gifts under certain circumstances, but the court held that it did not bar revaluation in this case because no gift tax had been "assessed or paid" in respect of the notes or of other gifts reported in 1984. The Tax Court further held that the value of the notes must be included in "adjusted taxable gifts" for estate tax purposes because the Code's definition of that term includes all post-1976 gifts, with no provision for the exclusion of particular gifts on the ground that the statute of limitations on assessment of gift tax has run for the period in which the gifts were made. Pet. App. 13a.

The court of appeals affirmed. The court pointed out, Pet. App. 4a, that although the statute of limitations on the gift tax for 1984 had expired, that statute "nowhere prohibits consideration of th[e] transfer [of the notes] as an 'adjusted taxable gift' when computing the estate tax." The court also rejected, *id.* at 6a, the estate's contention that Section 2504(c) barred inclusion of the gift in "adjusted taxable gifts" for purposes of Section 2001(b), ruling that "[b]y its terms, the section addresses the gift tax, and we decline to extend it to the estate tax." The court therefore found it unnecessary to consider the government's arguments that Section 2504(c) was inapplicable because no gift tax was assessed or paid with respect to the notes in 1984, and because the valuation of the gifts was never in dispute. Pet. App. 6a n.12.

ARGUMENT

1. Although the federal gift and estate taxes have always been closely related in purpose, until 1976 they remained separate in operation, with different rate structures, coverage, exemptions, and administration.[1] The separateness of the two taxes reduced the aggregate progressivity of the transfer tax system: although large lifetime transfers of wealth would not escape taxation, they would reduce the size of a taxpayer's estate at

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[1] The gift tax, enacted as Sections 501-532 of the Revenue Act of 1932, ch. 209, 47 Stat. 169, 245-259, was largely designed to protect the estate tax by limiting the avoidance of estate taxes through the use of lifetime transfers of property. See generally *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44 (1939); R. Magill, *The Federal Gift Tax*, 40 Columbia L. Rev. 772 (1940); L. Harriss, *Legislative History of Federal Gift Taxation*, 18 Taxes 531, 536-538 (1940). Although the taxes were separate before 1976, some lifetime transfers were previously subject to both taxes, with the gift tax later credited against the estate tax. See, *e.g.*, *Smith* v. *Shaughnessy*, 318 U.S. 176, 179 (1943).

death, and could therefore result in assessment of the estate tax at a lower marginal rate than would otherwise have been applicable. The annual gift tax did maintain progressivity for all lifetime transfers, because the marginal rate (or rates) applicable to gifts made in any given year was determined by reference to the cumulative total of all taxable gifts made by the taxpayer from the year of enactment onward.[2]

The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, integrated certain aspects of the federal gift and estate taxes by adopting a single rate schedule and creating a "unified" credit for the gift and estate taxes, thus extending to both taxes the cumulative progressivity previously achieved only under the gift tax.[3] Under the unified system, "lifetime gifts are cumulated and subjected to progressively higher rates of tax as the aggregate grows, and at death, they are cumulated with the

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[2] The gift tax for any year was generally calculated as the excess of a notional tax, computed at the rates in effect for that year, on the aggregate of all taxable gifts beginning with the effective date of the 1932 Act and including the taxable gifts for the year in question, over a notional tax computed at the same rates on the same cumulative amount of taxable gifts, but excluding those made in the year in question. The net effect of the calculation was to ensure that taxable gifts in the current year fell within a rate bracket (or rate brackets) reflecting the cumulative total of all such gifts made since the inception of the tax. See, *e.g.*, Revenue Act of 1932, ch. 209, § 502, 47 Stat. 246; Internal Revenue Code of 1939, § 1001; Internal Revenue Code of 1954, § 2502. The same computation method is retained under Section 2502 of the current Code.

[3] See 26 U.S.C. 2001, 2010, 2502(a), 2505. Not surprisingly, the statutory formula for maintaining overall progressivity in the computation of the estate tax, 26 U.S.C. 2001(b), is structurally similar to the formula developed to achieve the same goal with respect to the gift tax (see note 2, *supra*). For a statement of legislative goals and a detailed description of the operation of the single rate structure and the unified credit, see H.R. Rep. No. 1380, 94th Cong., 2d Sess. 11-12, 13, 15-17 (1976).

taxable estate in applying the same rate schedule. A unified credit of $192,800 is allowed against the first gift taxes imposed, and any portion of the credit not used against gift taxes is allowed against the estate tax." 5 B. Bittker & L. Lokken, *Federal Taxation of Income, Estates and Gifts* (2d ed. 1993) (Bittker & Lokken) ¶ 132.1 at 132-2.

2. Petitioner renews in this Court, Pet. 11-15, his claims that including the gifts made by the decedent in 1984 and never properly reported or taxed as additional "adjusted taxable gifts" for purposes of the estate tax computation under Section 2001 conflicts with the statute of limitations for assessment of gift taxes properly payable in 1984, see 26 U.S.C. 6501(a), and results in the improper inclusion of the amount of the previously untaxed gifts in calculating the tax on petitioner's estate. As the courts below recognized, however, the results petitioner complains of flow directly from a straightforward application of the statutory language.

Section 2001(b) requires calculation of a "tentative tax" based on an amount that includes not only the decedent's taxable estate but also all "taxable gifts" made after the 1976 integration of the gift and estate tax schedules but before death, and not already otherwise included in the taxable estate. The tentative tax is then compared to the aggregate amount of gift tax "which would have been payable," at the same rates as the estate tax, on post-1976 gifts. The structure of the statute makes clear that for purposes of Section 2001 the gift tax that "would have been payable" is offset by the unified credit provided, as to the gift tax, by Section 2505 of the Code—or, in other words, that a gift tax "would have been payable" for purposes of Section 2001(b)(2) only if an

actual payment of tax would have been required.[4] The excess of the tentative tax over the notional aggregate gift tax represents the appropriate estate tax, adjusted to tax the transfer of property at death at marginal rates that reflect taxable transfers made by the decedent during her lifetime.

As the courts below correctly held (Pet. App. 4a, 13a), nothing in Section 2001 or elsewhere in the Internal Revenue Code limits the term "taxable gifts" as used in Section 2001 to gifts on which the proper gift tax was previously paid or assessed. Similarly, nothing in the Code suggests where the proper gift tax was not in fact paid or assessed, the tax that "would have been *payable*" for purposes of Section 2001(b)(2) should be adjusted upward to account for the tax that should have been *reported* on the taxpayer's return, where any tax so reported would not in fact have been "payable" because it would have been offset by the unused credit still available for gift tax purposes under Section 2505. Rather, in this case the statute requires both inclusion of the decedent's improperly reported 1984 gifts in calculating her tentative estate tax, and recognition of the fact that

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[4] Section 2010 of the Code provides that the estate tax calculated under Section 2001 is to be offset by the entire amount of the unified credit (presently $192,800). The gift taxes "which would have been payable" with respect to lifetime gifts (Section 2001(b)(2)) directly reduce the final estate tax computed under Section 2001(b), which is later offset by the credit. Thus, including under Section 2001(b)(2) gift taxes that would never have been "payable" because they would have been offset by the application of the identical unified credit amount provided under the gift tax (26 U.S.C. 2505) would improperly reduce the estate tax calculated under Section 2001(b) and result in double application of the single "unified" credit. See generally Gov't C.A. Br. 13-14 & n.6; Staff of Joint Committee on Taxation, 94th Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1976* at 528 (1976), *reprinted in* 1976-3 C.B. (Vol. 2) 1, 540.

because at the time she had not exhausted the unified credit applicable to her lifetime transfers, no tax "would have been payable" in 1984 with respect to those gifts even if they had been properly reported as taxable on her return.

This result is consistent with well-settled law concerning the correction of reporting or assessment errors made in years no longer subject to adjustment, in so far as those errors affect the proper calculation of tax liability in later open years. In *Commissioner* v. *Disston*, 325 U.S. 442 (1945), for example, the taxpayer erroneously claimed gift tax exclusions with respect to three gifts made in trust in 1936. When the taxpayer's gift tax returns for 1937 and 1938 were examined, the statute of limitations barred assessment of additional gift taxes for 1936. For purposes of computing the gift taxes for the later years, however, the Court held that the erroneous exclusions should be corrected, and the full amount of the 1936 gifts included as prior taxable transfers. As the Court explained:

> Section 517(a) [the statute of limitations, now Section 6501(a)] does not purport to bar adjustment of the net gift figure for that purpose, but simply prevents assessment and collection of a tax for a year barred by the statute. The statute does not purport to preclude an examination into events of prior years for the purpose of correctly determining gift tax liability for years which are still open. The Tax Court and Treasury Regulations have construed § 517(a) as requiring determination of the true and correct aggregate of net gifts for previous years. The construction is in accord with the statutory language.

Id. at 449 (footnote omitted).

3. In enacting the 1954 and 1986 Codes Congress modified, to a limited extent, the statutory structure to which the Court referred in *Disston*. Section 2504(c) of the Code now provides that where gift tax has been "assessed or paid" with respect to a gift and the applicable statute of limitations has since expired, the value used to determine the tax so "assessed or paid" must generally be accepted for purposes of determining cumulative past gifts when calculating the gift tax due for any subsequent year.[5] Although petitioner scarcely mentions Section 2504(c) in his argument, see Pet. 15, he asserts a conflict between a district court opinion and a Tax Court opinion over the proper relationship between Sections 2504(c) and 2001(b). Pet. 15-16, citing *Boatmen's First Nat'l Bank* v. *United States*, 705 F. Supp. 1407 (W.D. Mo. 1988), and *Estate of Smith* v. *Commissioner*, 94 T.C. 872 (1990).

As the court of appeals held (Pet. App. 6a), Section 2504(c) "[b]y its terms * * * addresses the gift tax," and petitioner's apparent attempt to extend its strictures to the estate tax context is unconvincing. Moreover, as the Tax Court pointed out in its opinion, Pet. App. 12a, even in the gift tax context the operation of Section 2504(c) is limited to circumstances where tax has been "assessed or paid" with respect to a gift, and the taxable value of the gift is subsequently questioned. The Treasury Department's gift tax regulations have made clear since 1958 that where no tax has been assessed or paid on a particular gift, Section 2504(c) does not preclude correction of valuation or other errors made with respect to

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[5] Section 2504 is based on the proposition that where the value reported in or settled upon for the barred year was accepted by both the government and the taxpayer, and a tax paid, "this value should be acceptable to both in measuring the tax to be applied to subsequent gifts." H.R. Rep. No. 1337, 83d Cong. 2d Sess. 93-94 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 127, 479 (1954).

that gift for purposes of computing the gift tax due for a later year, even if correction of such errors for purposes of reassessing the tax due in the prior year would be barred by the statute of limitations. 26 C.F.R. 25.2504-1(d), 25.2504-2. See also 5 Bittker & Lokken ¶ 132.2.2 at 132-7 to 132-8. In this case, the error in decedent's 1984 gift tax return lay in the claimed exemption of the $20,000 in notes. Because no gift tax was ever assessed or paid with respect to the transfer of those notes, nothing in Section 2504(c) (or elsewhere in the Code) would bar correction of the erroneous exemption in subsequent gift tax computations, let alone in estate tax computations under Section 2001(b).

The decisions in *Boatmen's First Nat'l Bank* and *Estate of Smith* both involved disputes over the revaluation, for estate tax purposes, of gifts made and actually taxed in prior years. See also *Stalcup* v. *United States*, 792 F. Supp. 714 (W.D. Okla. 1991) (same, rejecting *Boatmen's* and agreeing with *Smith*). Because they involved situations where the threshold requirements for application of Section 2504(c) were met, they presented issues not properly raised here.[6] Even if those cases raised issues identical to those presented in this case, however, review would be inappropriate here. Petitioner identifies no conflict between the decision below and any decision of this Court or of another court of appeals. This Court need not resolve conflicts between a court of appeals and a district court in another circuit, let alone conflicts between two courts of first instance. See

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[6] But see *Evanson* v. *United States*, No. A1-92-099 (D. N.D. Apr. 6, 1993), appeal pending, No. 93-2689 (8th Cir.) (holding Section 2504(c) applicable to bar revaluation of a gift for estate tax purposes where no gift tax would have been payable in year of gift, even after revaluation, because of application of unified credit).

generally R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 207 (6th ed. 1986).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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